Weekly Macro & Markets View

Highlights and View

- **Fumio Kishida has been elected as Japans's 100th PM, while the Covid state of emergency has been lifted**

  It will be essential for PM Kishida to focus on sustainable growth and reform, although Japan's economy already seems to be gaining steam based on the latest Tankan Survey.

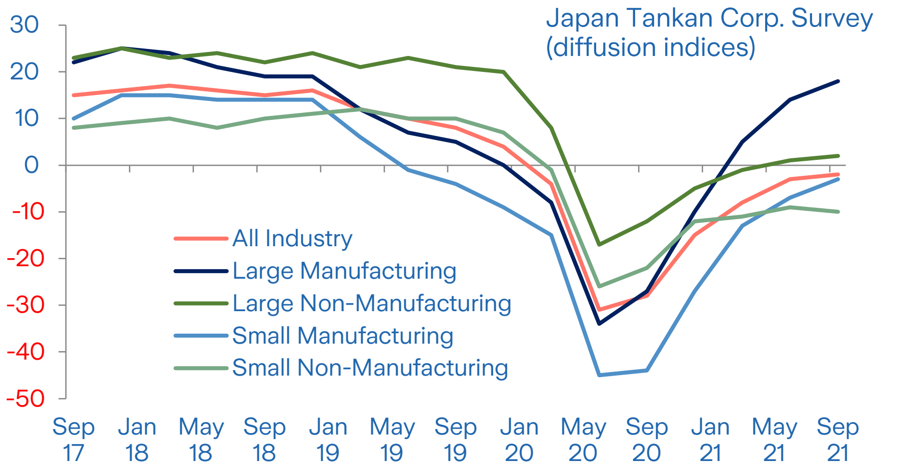
- **Eurozone headline inflation increases from a 10-year high in August to a 13-year high in September**

  The spike in the headline inflation numbers probably exaggerates the size of the underlying move, but we do think that inflation is gradually moving higher in the region.

- **Credit markets seemed like an oasis of calm last week despite the jitters seen in stock markets**

  Credit is typically a leading indicator of major market disruptions, hence the recent calmness is encouraging as it implies investors view current volatility as transient.

Kishida is Japan's new Prime Minister



Source: Bank of Japan, Bloomberg

Fumio Kishida, former Foreign Minister under PM Abe, was elected today as Japan's 100th Prime Minister following his second-round win in the LDP presidential elections last week. Among four candidates, Kishida led the first-round election neck and neck with Taro Kono, the Minister for Administrative Reform, who will now become Chairperson of Public Relations. While Kono won the majority of votes cast by more than one million LDP members, Kishida was favoured by the Diet members, who tend to prefer political stability over reform. Although the new cabinet was presented today, Lower House snap elections are now scheduled for October 31. Equity market participants seemed disappointed, with the Topix falling every day since the LDP elections, though Wall Street's weakness also had a negative impact. We will carefully watch whether Kishida will continue to focus on distribution versus growth and reform. Our outlook for the economy remains favourable as the Covid induced state-of-emergency for affected prefectures has been lifted, new Delta infection cases have receded significantly, and the vaccination rate is improving further. The quarterly 'Tankan' corporate survey came in better than consensus had expected. Sentiment among large manufacturing companies has improved markedly, though the non-manufacturing sectors keep languishing. However, we expect conditions to improve, as consumer confidence and turnover should recover quickly.

US: The S&P 500 suffers its worst week since February

Despite a decent rebound on Friday the S&P 500 still ended the week 2.2% lower, the worst weekly performance since February. Beneath the surface, the sector rotation continued with energy and banks outperforming while technology stocks struggled. The Nasdaq declined 3.2% on the week. Meanwhile, economic data paint a slightly mixed picture. The ISM Manufacturing Index rose to 61.1 in September with strong new orders pointing at a continuation of solid business activity. Consumer sentiment remains under pressure, however, with the Conference Board's survey falling to the lowest since February, weighed down by both the current perception and expectations. Buying intentions weakened, particularly for large items, reflected in the fall of vehicle sales to a post-recession low in September. There was little progress on the political front as negotiations on the infrastructure package and the debt ceiling keep dragging on. On a positive note, a looming government shutdown for the beginning of October has been avoided for now as Congress passed a nine-week stopgap funding bill.

Eurozone: Inflation rises further, but unemployment falls

Eurozone inflation hit a fresh multi-year high, rising from 3.0% in August to 3.4% YoY in September on the headline measure, and from 1.6% to 1.9% on the core measure. The drivers were a mix of factors. Energy inflation rose two percentage points from 15.4% to17.4% and was again a big contributor to headline inflation. However, services inflation also picked up, though partly related to HICP weighting changes this year. Even higher inflation prints are likely over the next few months. Gas and electricity prices have risen sharply in recent weeks, but the full impact has not yet been passed on to consumers, and further increases in energy inflation are possible over the next few months. The sharp increase in inflation will make the ECB's communication job more challenging, but we still expect it to continue with a substantial amount of asset purchases this year and next. Meanwhile, other data released last week were more encouraging. Unemployment continues to gradually trend down and the EC economic sentiment indicator picked up slightly.

Asia: PMIs paint a mixed picture, while South Korea's exports surge to a record high

September Manufacturing PMIs showed that economic conditions for major ASEAN countries improved for the second month in a row, though not all managed to move above 50. Conditions remain difficult in Vietnam and Myanmar. The aggregate ASEAN PMI improved from 44.5 to 50. Taiwan's PMI fell for the second month in a row, though it remains clearly above 50. While strong semiconductor exports are driving growth, domestic consumption remains lacklustre. Australia's Manufacturing and Services PMIs both improved, though the latter remains below 50. China's NBS and Caixin PMIs painted a mixed picture, with the NBS Manufacturing PMI falling below 50, a reflection of early power supply problems. South Korea's export value reached a record high in September on solid semiconductor, mobile and auto exports. Industrial production and consumer related statistics are also encouraging. Australia's house prices continued to rise at a pace of 1.6% MoM nationwide, with Sydney and Brisbane leading the pack. Home sales continue to be brisk in Sydney but have weakened in Melbourne.

LatAm: Banxico hikes as expected, economic activity continues to surprise in Chile

In a split decision, Banxico raised the monetary policy rate by 25bps to 4.75%, driven by the upside risk to inflation and expectations. Although the balance of risks for inflation is upward, the board maintains that price shocks are transitory and inflation will begin to decrease in 2022, reaching its target of 3% by the end of 2023. Economic activity in July increased by 0.54% MoM, below market expectations, and the labour market participation rate fell while unemployment remained stable at 4.3%.

In Chile, the lower house approved the fourth withdrawal from pension funds, but by a tight margin, receiving 94 positives votes (where 93 needed), while the previous withdrawal obtained 120 positive votes. The bill will now be voted on in the Senate, where we believe it is more challenging to be approved. Economic activity surprised the upside for the sixth consecutive month, growing 1.1% MoM in August, driven by services. The labour market continues to recover, with the unemployment rate falling from 8.9% to 8.5%.

Credit: An oasis of calm amid broader market jitters

Credit markets, often a leading signal of stress ahead of major market disruptions, have been remarkably stable over the last few weeks. Last week, while spreads softened modestly, the softness paled in comparison to the gyrations in stock markets. Not only were the secondary markets holding in well, but the primary market also confirmed strong demand. While European and US investment grade primary markets saw decent activity, US high yield saw robust volumes with heavy oversubscription. In fact, led by a Medline deal, Thursday saw around USD 10 billion of debt sold in the US high yield market, making it one of the busiest days in many years. The concerns around Evergrande, as well as the rise in bond yields, have not deterred credit demand, as can also be seen from the broad inflows into credit funds. It seems that credit investors are looking through a lot of current stock market volatility as noise and are focussed more on longer-term trends of improving credit fundamentals, as reflected by some notable upgrades last week.

What to Watch

- In the US, investors will focus on the latest labour market report as it will set the stage for the Fed's next move. Even a modestly positive report is unlikely to deter the Fed from beginning to taper its asset purchases in November.
- In APAC, we believe Australia's RBA and India's RBI will keep policy rates unchanged, whereas New Zealand's RBNZ is likely to raise its policy rate by 25bps to 0.5%. We will focus on Hong Kong's Policy Address as well as Japan's September Eco Watchers Survey. Taiwan will release September export data, while several countries will publish CPI data for September. Australia's financial markets will be closed on Tuesday (Labour Day), while Mainland China's markets will reopen on Friday.
- In LatAm, the focus will be on inflation for Brazil, Chile, and Mexico. Industrial production, retail sales, and PMIs in Brazil will also be released.

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Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

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